Tab A

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of		
Application of SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California	)	WC Docket No. 02-306

DECLARATION OF MICHAEL R. LIEBERMAN AND BRIAN F. PITKIN ON BEHALF OF AT&T CORP.

I. BACKGROUND AND SUMMARY

1. My name is Michael R. Lieberman. I am a District Manager in AT&T's Law and Government Affairs organization. In this position I am responsible for providing financial and industry analytical support relating to the costing and pricing of local telecommunications services. I was AT&T's primary participant in the development of the HAI/Hatfield Model of forward looking economic costs for local exchange networks and services, and I have been responsible for evaluating other costing models and methodologies such as the BCPM and the FCC's Synthesis Model. I have a Bachelor's degree in mathematics and a Master's degree in statistics from the State University of New York at Stony Brook. Prior to joining AT&T as a statistical consultant in 1978, I was a bio-statistical consultant with Carter-Wallace of Cranbury, New Jersey.

2. My name is Brian F. Pitkin. I am a Director in the Financial Consulting Division of FTI Consulting, Inc. During the past six years, I have had extensive experience with the cost models and underlying databases that have been submitted in proceedings arising out of the

Telecommunications Act of 1996 ("1996 Act"). I have testified on the inputs and methodologies used in a variety of cost models and cost studies used in state and federal proceedings for estimating costs of (1) unbundled network elements ("UNEs") for interconnection, (2) basic local service for universal service fund ("USF") requirements, and (3) access services. I received a Bachelor of Science degree in Commerce, with concentrations in both Finance and Management Information Systems, from the McIntire School of Commerce at the University of Virginia in 1993.

II. PURPOSE AND SUMMARY OF TESTIMONY

3. The purpose of our testimony is to demonstrate that Texas rates cannot legitimately be used in the Commission's benchmarking test to justify rates in California.

4. In Part III, we conclusively demonstrate that Texas rates are not remotely TELRIC-compliant. The Commission's benchmarking test is a short-cut method for assessing whether rates in an applicant state are TELRIC-compliant. If the cost-adjusted rates in the applicant state are lower than the cost-adjusted rates in a state where rates that are known to be TELRIC-compliant (the "benchmark" state), then it is logical to presume that the rates in the applicant state also are TELRIC-compliant. A critical characteristic of the benchmark state, therefore, is that the rates in the benchmark state are TELRIC-compliant. *Pennsylvania 271 Order* ¶ 67 ("without a finding of TELRIC compliance for the benchmark state, a comparison loses all significance.").

5. The Texas Public Utilities Commission ("TPUC") has found that the Texas rates – which were originally adopted in 1998, based on 1997 cost-studies and 1996 and earlier data – are stale in are in dire need of updating. These findings are confirmed by the Commission's Synthesis Cost Model and by Southwestern Bell Telephone's ("SWBT's") reported data, which confirm that the costs of providing UNEs in Texas has declined substantially since those rates

were originally adopted. Thus, Texas rate are not a valid benchmark against which to compare California rates.

6. In Part IV, we demonstrate that other relevant factors identified by the Commission (*see, e.g., Rhode Island 271 Order* ¶ 38) for assessing whether Texas is a valid benchmark state also militate against using Texas as a benchmark state: (1) Texas rates are based on a different rate structure than California; (2) Texas and California have dissimilar geographic characteristics that affect cost; and (3) Texas and California are served by different BOCs.

7. The bottom line is this: all of the factors that the Commission has identified as relevant for identifying valid benchmark states militate against using Texas as a benchmark state in this proceeding.

III. TEXAS RATES ARE NOT TELRIC-COMPLIANT.

8. As noted, the Commission's benchmark test is a short-cut for assessing whether rates in an applicant state are TELRIC-compliant. If the cost-adjusted rates in the applicant state are at or below those in the "benchmark" state where rates are known to be TELRIC-compliant, then it is reasonable to presume that the rates in the applicant state also are TELRIC-compliant. Thus, a valid benchmark state must have TELRIC-compliant rates.

9. Texas rates are plainly exceed TELRIC levels, rendering Texas rates an invalid benchmark against which to compare California's rates. The TPUC has expressly recognized that the Texas rates, which are based on 1996 and earlier data are do not reflect the substantial costs changes that have occurred since then:

> [T]he evidence show[s] that SWBT's deployment of Project Pronto has changed loop plant technology, technology mix, and processes regarding loop deployment and maintenance. There is also evidence that engineering assumptions (such as higher percentage

> of the use of remote terminals and fiber feeder) have changed as a result of Project Pronto. . . . Project Pronto has caused the use of more fiber, declining cost of electronics, lower cost structure for NGDLC, and a reduction of the number of dispatches and maintenance processes and lower overall costs. The evidence of such changed circumstances is sufficiently compelling to merit and investigation of SWBT's forward-looking loop costs and, therefore, the UNE rates.[1]

Moreover, the TPUC rejected SBC's arguments that current Texas rates are cost-based:

> [T]here was insufficient evidence introduced by SWBT for . . . to conclude that the current rates, based on the previous cost studies and data from the 1996 Mega-Arbitration, are appropriate. . . . [T]here is inadequate evidence to support the assertion that assumptions built into the 1997 Mega-Arbitration cost studies sufficiently address current deployment.[2]

Accordingly, the TPUC has opened a new proceeding to update Texas' outdated UNE rates.

10. These findings are independently confirmed by the Commission's Synthesis Cost Model, which shows that SBC's forward-looking costs of providing loops and switching in Texas have declined by 29% and 33% respectively. These results are based on runs of the Commission's Synthesis Cost Model using both 1996 and 2001 line count and dial equipment minutes ("DEMs") data.[3] That analysis confirms that the 49% increase in the number of lines in Texas has resulting in 29% decline in per-line costs (because SBC's total costs are spread over more lines).[4] *See* Table 1 (below). Likewise, the 40% increase in DEMs has resulted in a 33%

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[1] *Texas 2002 Arbitration Order*, at 110.

[2] *See id.*

[3] Updating only the inputs for line counts and dial equipment minutes ("DEMs"), the Synthesis Cost Model estimates primarily the forward-looking cost differences associated with the substantial increase in economies of scale during this time frame.

[4] This analysis likely understates actual cost reductions because SBC's ARMIS data does not appear to include UNE-P lines, which have grown substantially since 1996.

reduction in per minute switch costs (again, because total switch costs are spread over more minutes).[5] *Id.*[6]

Table 1
Synthesis Cost Model Results

Category	1996 Data	2001 Data	Total Change
Demand Data			
Line Counts	10,357,493	15,383,354	48.5%
Dial Equipment Minutes (DEM)	193,597,825	269,006,000	39.0%
Capital Costs			
Loop Costs per Line	$ 8.57	$ 6.08	-29.0%
Switch Costs per DEM	$ 0.00103	$ 0.00069	-33.2%

11. The cost data reported by SBC in its ARMIS reports provides additional independent confirmation that the Texas rates are far above TELRIC levels. That data shows that SBC's actual costs – not forward-looking costs – also have declined substantially since 1996. In particular, SBC reports data that includes cable and wire facility investment, circuit equipment investment and switching equipment investment (*see* ARMIS schedule 43-03 report). The cable and wire facility investment and the circuit equipment investment can be used to estimate reductions in loop costs.[7] And the switching equipment investment can be used to estimate per minute switching cost reductions.

[5] Switch-related costs represent, by far, the largest single component of non-loop costs (typically around 90%).

[6] Moreover, the Commission's cost model develops plant-specific expenses based on the assumption that these expenses are directly related to investments. In other words, these expenses are developed using expense-to-investment ratios and are applied to forward-looking investments. Thus, a 29% reduction in loop costs per line represent an equivalent 29% reduction in plant-specific loop expenses per line (because the forward-looking investments are the numerator to which the expense-to-investment ratio is applied).

[7] Cable and wire investment can be used as a proxy for assessing the changes in Pacific's loop costs because these accounts include almost all of the investment categories (*i.e.*, cable and structure) that comprise loop investments. Indeed, outside loop plant comprises the vast majority of the total cable and wire investments. Circuit equipment shows investment in DLC equipment, and thus reflects investment in fiber-fed loops.

12. To compute per-line cable and wire facilities and circuit equipment investment, we divided the cable and wire facility investment and the circuit equipment investment by the line count data reported by SBC in ARMIS schedule 43-08. Likewise, to compute per-DEM switch investment, we divided the switching equipment investment by the DEM data reported by SBC in ARMIS schedule 43-04 report.

13. As shown in Table 2 (below) this analysis further confirms that SBC's Texas loop and switching costs have declined dramatically since 1996 – by 28% and 18%, respectively. As noted, the reason that these cost declines appear lower than those computed by the Commission's Synthesis Cost Model is that SBC's reported data shows embedded accounting cost declines, whereas the Commission's Synthesis Cost Model shows *forward-looking* cost declines.[8]

Table 2
Net Investments per Unit of Demand

	Net Investment per Unit						Total
Category	1996	1997	1998	1999	2000	2001	Change
Cable & Wire Facilities per Line	$ 356.09	$ 346.49	$ 308.82	$ 278.15	$ 303.19	$ 256.38	-28.0%
Total Cable, Wire & Circuit per Line	$ 526.07	$ 527.39	$ 484.47	$ 445.67	$ 513.78	$ 454.02	-13.7%
Switching Equipment per DEM	$ 0.01006	$ 0.00936	$ 0.00898	$ 0.00816	$ 0.00771	$ 0.00824	-18.1%

14. It is important to note that the cost declines identified by the Commission's Synthesis Cost Model and by SBC's Texas ARMIS data are only the tip of the iceberg.[9] For example, these analyses do not reflect the significant reductions in SBC's common support expenses that have been experienced over time. Indeed, SBC's common support expenses (*i.e.*, "executive & planning," "general & administrative," "marketing," and "services expenses") have

[8] Each snapshot of accounting data necessarily represents data over multiple years and does not reflect current costs (or even year-by-year actual cost declines).

[9] Notably, SBC's current DLC penetration rates in Texas, the accounting cost decline in loop plant will be closer to the 28% decline than the 14% decline.

declined from $9.68 per-line in 1996 to $6.79 in 2001 – a reduction of 30%.[10] Moreover, as recognized by the TPUC, there are other factors that contribute to further cost declines, including the deployment of a more modern network (Project Pronto), and numerous mergers and acquisitions that allow SBC to operate more efficiently. Thus, the true amount by which Texas are overstated likely exceeds by a substantial amount, the levels shown Tables 1 and 2 above..

15. The bottom line is this: the TPUC has determined that Texas rates are hopelessly outdated, because those rates are based on outdated 1996 and earlier data. The TPUC's findings are confirmed by two independent analyses of Texas' cost, which show that both SBC's Texas *forward-looking* loop and switch costs (Synthesis Cost Model Analysis) and SBC's Texas *current* loop costs and switch costs (ARMIS data analyses) have declined. Thus, Texas is not a valid benchmark state, and cannot legitimately be used in the Commission's benchmarking test.

IV. CALIFORNIA AND TEXAS HAVE DISSIMILAR RATE STRUCTURES AND GEOGRAPHIC CHARACTERISTICS.

16. Even aside from the fact that Texas rates are not TELRIC-compliant, there are other reasons for rejecting TELRIC as a benchmark state. As noted by the Commission, there are other indicia relevant – although not determinative – to whether a particular state's rates are an appropriate TELRIC benchmark. Those indicia include, (1) whether the proposed benchmark state has geographic similarities to the applicant state; and (2) whether the proposed benchmark state and the applicant state have a common BOC; (3) whether the proposed benchmark state has a similar rate structure to the applicant state.[11] All of these additional indicia militate *against* using Texas rates as a benchmark for assessing California's rates.

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[10] This expense data is based on the ARMIS schedule 43-03 report for accounts 6610, 6620, 6710, and 6720. The line data is based on the ARMIS schedule 43-08 report.

[11] *Rhode Island 271 Order* ¶ 38; *see also Missouri/Arkansas 271 Order* ¶ 56; *Pennsylvania 271 Order* ¶ 63; *Massachusetts 271 Order* ¶ 28; *Kansas Oklahoma 271 Order* ¶ 82.

17. *Geographic Differences.* Pacific claims that Texas is an appropriate benchmark because California and Texas "share certain demographic and geographic features."[12] But Pacific ignores the key geographic characteristics that determine whether it is appropriate to use Texas as a benchmark state for assessing California's rates. In particular, Pacific refers to Commission almanac-style statistics – *i.e.*, population, number of households, persons per household, land area, number of urban places, population density in large cities, and the number of central offices, most of which have little if any impact on actual cost differences between California and Texas.

18. The relevant geographic statistics for determining whether two states are sufficiently similar that they can be benchmarked against one-another relate to the geographic dispersion of *telecommunications* equipment and customers. These differences can be fairly represented by evaluating line density characteristics and the average characteristic of the wire centers served by SBC in Texas and Pacific in California. These statistics include the number of households served in each wire center, the average number of lines served by each wire center, and the average area served by a wire center.[13] As shown in Table 3 (below) these statistics are radically different for Texas than for California, making it difficult to conduct an apples-to-apples comparison of the rates in those states. Thus, Pacific's claim that California and Texas have sufficiently similar geographic characteristics to justify using Texas as a benchmark state is clearly erroneous.

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[12] *Makariwicz* Decl. ¶ 9.

[13] The wire center is the appropriate basis for consideration for several reasons. First, the Commission's scorched-node approach holds wire centers constant while otherwise constructing facilities in the most efficient manner. Second, the wire center is the basis by which costs are most often calculated in both state and federal proceedings. Third, it is practically impossible to make comparisons between states at any level lower than a wire center. Moreover, this approach guarantees that the geographic comparisons are relevant to SBC's and Pacific's actual territory in Texas and California and does not include territory served by other providers.

Table 3
Geographic and Demographic Comparison

Item	Texas	California	% Diff
Average Households per Wire Center	9,792	14,426	47%
Average Lines per Wire Center			
Residential Lines	9,811	17,844	82%
Business Lines	8,233	11,342	38%
Special Lines	5,151	9,122	77%
Total	23,194	38,308	65%
Average Area per Wire Center	79	52	-35%
Average Density (Lines per Square Mile)	293	742	153%
Average Route Distance per Line	45,201	27,368	-39%

19. *Rate Structure.* The Commission also has explained that a state may be an appropriate benchmark if it has a similar rate structure to the applicant state.[14] There are substantial differences between the rate structures of California and Texas. For example, to compare the average non-loop charge in California and Texas it is necessary to know the average vertical feature charge – which is a component of the non-loop category. But the rate structures in California and Texas recover vertical features cost in entirely different ways. Whereas Pacific recovers the cost of vertical features through 31 different rate elements, SWBT recovers the costs of vertical feature costs through the traditional switch related rate elements. That means that it is necessary to convert the 31 California vertical features charges into an average rate that is actually paid by Pacific's customers, which requires estimation of penetration rates for the 31 vertical features in California.

[14] *Rhode Island 271 Order* ¶ 38; *see also Missouri/Arkansas 271 Order* ¶ 56; *Pennsylvania 271 Order* ¶ 63; *Massachusetts 271 Order* ¶ 28; *Kansas Oklahoma 271 Order* ¶ 82.

20. There also are other important differences between the rate structures in California and Texas. For example, California's switching rates utilize a "set-up and duration" cost structure which requires accurate assumptions about the duration of the average call in California in order to develop rates that can be benchmarked to Texas.[15] The Texas rate structure is unique compared to all other states in that the port rate is based on rate-groupings that depend on the size of the calling areas served by particular wire centers. Moreover, these four port rate groups do not correspond to the three UNE zones used for other elements, requiring that these port rates be mapped to the three UNE zones at the wire center level.[16] Any benchmarking comparison between California and Texas therefore would have to accurately measure the port rate in Texas in such a way that it is comparable to the port rate in California.[17]

21. *Different BOCs.* California and Texas are clearly served by different BOCs – Pacific in California and Southwestern Bell Telephone in Texas. To the extent California's and Texas rates are affected by differences between the BOCs (the rates in these states were developed *before* SBC controlled both BOCs), then a rate comparison between Texas and California would be less useful to assessing whether California's UNE rates are TELRIC-compliant. Indeed, different BOCs have different overhead costs, operate on different scales (which may even affect the discounts received for equipment), and deploy different network architectures. Moreover, different BOCs estimate costs using often entirely different cost

[15] California usage rates have three pairs of set-up and duration rates: a pair for interoffice originating, interoffice terminating and intraoffice. Thus, in addition to determining three holding times, it is also necessary to know the percent of traffic that is intraoffice in order to perform a switch cost comparison to determine the per minute equivalent of the three set-up rates.

[16] This complex rate structure is exasperated by having usage-related switch and transport costs that vary by UNE zones. Thus, a portion of switch-related costs are recovered by port rate groups and a portion by UNE rate groups that do not correspond.

studies. As explained in the attached declaration of Terry Murray (¶ __), PacBell's costs studies are very unique compared to those in other SBC states.[18]

V. CONCLUSION

22. Recent findings by the Texas state commission and analysis of Texas costs confirm that Texas rates are not a valid benchmark for assessing Pacific's California rates.

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[17] The difficulty in assessing the Texas port rate is underscored by the fact that the average port rate in Texas (according to various representations made by SBC) has ranged from $2.22 to $2.90 during SBC's various 271 proceedings.

[18] AT&T is not raising price squeeze issues in this proceeding. It is notable, however, that the price squeeze testimony relating to residential UNE-P entry and access services filed by Pacific Bell witness, Mr. Lehman, each contain several conceptual and methodological errors. Some of these fundamental errors include:

Residential UNE-P Price Squeeze. First, Mr. Lehman claims, with no support, that a proper margin analysis should include revenues for more than three vertical features. Lehman 6-7. There is no evidence that the average residential customer in California purchases more than three vertical features. Second, Mr. Lehman claims a proper margin analysis should be based on targeted entry strategies to only the highest valued customers in California. *Id.* at 9. The relevant inquiry, however, is whether the markets in California are generally open to local entry, not whether it would be economically feasible for a few new entrants to provide services to a small sliver of the residential local market. Indeed, all California customers – not only the wealthiest customers – should have access to the full benefits of local telephone competition. These and other fundamental errors in Mr. Lehman's declaration require that the analysis be given no weight.

Access Price Squeeze. Mr. Lehman concedes that there is a "theoretical price squeeze situation" in California, but claims that the price squeeze has been "incorrectly portrayed." Lehman Decl. 17 (at page 12) (there is more than one paragraph 17 in Mr. Lehman's testimony). Mr. Lehman's argument, however, is fundamentally flawed. As demonstrated in the California state proceedings, there exists the potential for a price squeeze in access markets. For example, as noted by Mr. Lehman (at 17), where an ILEC's underlying costs of providing access are $.002/minute, the average access charge by ILEC's to IXCs is $.01/minute, and non-access toll costs incurred by both ILECs and IXC's are $.03/minute, an IXC's per minute costs will be $.03 + $.01(2) = $.05/minute. But the ILEC's cost will be only $.03 + $.002 (2) = $.034/minute. As a result, the ILECs' cost of providing service will be $.05 - $.034 = $.016/minute. Thus, there is a potential for a price squeeze. Mr. Lehman claims that this analysis is flawed because it should account for the fact that when an ILEC sells service to an IXC the ILEC forgoes $.05 - $.034 = $.016/minute in revenues. This argument misses the point. Where an ILEC's actual costs are substantially lower than the IXC's actual costs, the ILEC will earn more than the IXC for every access minute. This creates the potential for the ILEC, which owns the bottleneck access facilities, with an unfair competitive advantage over the IXC. Moreover, Mr. Lehman's assertion that IXCs could avoid the price squeeze by purchasing services from competitive access providers is wrong. Lehman 24. As Mr. Lehman should be well aware, the small amount of local entry in California has not resulted in access capacity that is remotely sufficient to handle the demand in California. Because of these and other fundamental flaws in Mr. Lehman's analysis, that analysis should be given no weight.

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Michael R. Lieberman

Michael R. Lieberman

Executed on: October 9, 2002

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Brian F. Pitkin

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In the Matter of Application of SBC Communications Inc., Pacific Bell Telephone Company, and Southwestern Bell Communications Services, Inc. for Provision of In-Region, InterLATA Services in California	)	CC Docket No. 02-306

DECLARATION OF TERRY L. MURRAY

I. QUALIFICATIONS AND BACKGROUND

1. My name is Terry L. Murray. I am President of the consulting firm Murray & Cratty, LLC. My business address is 227 Palm Drive, Piedmont, CA 94610.

2. I am an economist specializing in analysis of regulated industries. I received an M.A. and M.Phil. in Economics from Yale University and an A.B. in Economics from Oberlin College. At Yale, I was admitted to doctoral candidacy and completed all requirements for the Ph.D. except the dissertation. My fields of concentration at Yale were industrial organization (including an emphasis on regulatory and antitrust economics) and energy and environmental economics.

3. My professional background includes employment and consulting experiences in the fields of telecommunications, energy and insurance regulation. As a consultant, I have testified on telecommunications issues in proceedings before state regulatory commissions in California, Connecticut, Delaware, the District of Columbia, Florida,

Georgia, Hawaii, Illinois, Kansas, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nevada, New Jersey, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Washington and Wisconsin, and before the Federal Communications Commission ("FCC" or "Commission"). My testimony in these proceedings has concerned such issues as costing and pricing for retail services, unbundled network elements ("UNEs") and interconnection; universal service policy; competition policy (including policy toward proposed mergers); and incentive regulation.

4. Before I became a consultant in 1990, I was employed in a variety of positions (including Director of the Division of Ratepayer Advocates) at the California Public Utilities Commission ("CPUC") for approximately six years and had significant responsibility for telecommunications matters. I have also taught economics and regulatory policy at both the undergraduate and graduate levels.

5. The purpose of my testimony is to demonstrate that the rates for UNEs adopted by the CPUC are inflated by clear TELRIC errors.

II. PACIFIC BELL'S NONRECURRING CHARGES ("NRCs") ARE OVERSTATED BECAUSE THEY INCLUDE RECURRING COSTS.

6. In December of 1998, the CPUC noted that Pacific Bell's proposed NRCs include "[s]o called 'loaded' recurring costs represent[ing] approximately 25% of the total costs for NRCs."[1] CLECs argued that Pacific Bell's attempt to recover recurring costs through NRCs violated the Commission's TELRIC pricing rules. As noted, the CPUC agreed

that Pacific Bell's NRCs recovered those recurring costs. However, the CPUC refused to fix the problem at that time noting that, "[w]e are well aware of the FCC's August 8, 1996 First Report & Order that prohibited the ILECs from recovering recurring costs in NRCs, but that requirement has been stayed by the Eighth Circuit. Should the Supreme Court reverse the Eighth Circuit's stay on pricing provisions of the First Report & Order, we will direct Pacific . . . to remove [the recurring costs] . . . from their nonrecurring cost studies."[2] The Supreme Court has now reversed the Eighth Circuit's stay of the pricing provisions of the in *First Report & Order* and has also affirmed the validity of the TELRIC methodology. However, the CPUC has not required Pacific to remove the recurring costs from its NRCs. Thus, the CPUC's own findings demonstrate that Pacific's NRCs may be as much as 25% above properly calculated TELRIC-based prices.

7. The importance of properly recovering recurring costs only through recurring rates cannot be overstated. Inflating NRCs with recurring costs creates a substantial barrier to competitive entry. In the face of such overstated NRCs (which are paid up-front by carriers), new entrants face increased risk, because the amount of certain loss – *i.e.*, the NRCs – increases if the carrier's entry plans are unsuccessful. That is presumably why the Commission's rules *forbid* the shifting of recurring costs to non-recurring charges, 47 C.F.R. 51.507(d) ("recurring costs shall be recovered through recurring charges").

[1] CPUC Decision 98-12-079, at 51 (December 17, 1998). Loaded recurring costs are costs associated with items such as "such as office furniture, equipment and motor vehicles," which the CPUC acknowledged are recurring in nature. *Id.* at 52.

[2] *Id.* at 53.

III. PACIFIC'S VERTICAL FEATURES CHARGES ARE NOT TELRIC-COMPLIANT.

8. Pacific Bell's recurring cost study – on which its current rates are based – further violates TELRIC principles by including costs for vertical features that it does not actually incur. In particular, Pacific's switch rates are inflated because it charges competitive LECs separate fees, which range from $0.09 to $0.53 per month for *each vertical feature* (*e.g.*, "caller ID," "three way calling" and "call forwarding"), even though Pacific's incremental cost of providing vertical features is zero (or, at most, quite small).

9. Vertical features are generally provided by using hardware and software features that are already built into the switch. The cost for most of this functionality is included in the up-front price that ILECs pay for switches. Pacific does not incur any incremental switch-related cost to provide an additional feature to its customers, other than perhaps a cost to "activate" that feature for the customer. (This activation cost is normally recovered through non-recurring charges.) Thus, in nearly all states except California, ILECs do not separately bill vertical features to competitors, but instead recover the cost for access to vertical features as part of the port (or, in some cases, per minute of use) prices.[3]

10. Pacific Bell's separate vertical feature charge is not remotely TELRIC-compliant. Indeed, Pacific Bell artificially *created* vertical feature costs that would not exist without its unique costing methodology.[4] Most notably, the bulk of Pacific Bell's supposed costs

[3] *Accord Local Competition Order* ¶ 414 ("the record indicates that the incremental costs associated with vertical switching features on a per-line basis may be quite small").

[4] I have reviewed cost studies developed by each Regional Bell Operating Company and note that Pacific's expense analysis was uniquely complex. At a very high level, Pacific began by developing retail expense estimates using a manually intensive process of reviewing hundreds of expense categories at the "function code" level of internal accounting data. Pacific then assigned those cost to one of many "buckets" such as headcount-related costs or revenue-related costs. Pacific ran this data through a (never produced) mainframe computer model using hundreds more "logic rules" to assign expenses to services. Finally, Pacific overlaid some of these results with proxies

per feature consists of expense "proxies" that Pacific claimed that it incurs just because it treats each UNE feature as a separate service. For example, a large portion of Pacific's cost per feature is its supposed cost to "manage" and bill each of the individual feature "products." But such feature-related expenses could only exist (assuming they exist at all) because Pacific Bell insists on billing each single feature separately. Hence, Pacific has managed to create entire categories of cost that need not exist at all for its competitors through its unique proliferation of individual UNE rate elements.

11. The artificially high prices for vertical features that Pacific currently imposes on competitors create a substantial opportunity for Pacific to exercise its market power and shut out potential UNE-based competitors. Pacific can choose whether and, if so, how it incurs product management costs on the retail side (by deciding to offer features individually, rather than as part of packages), whereas competitors must pay Pacific to "product manage" individual features, regardless of the manner in which the competitors offer those features to their retail customers. Consequently, UNE-based competitors in California would be unable to provide retail local telecommunications services that include vertical features at prices that would be competitive with Pacific. Thus, Pacific's arbitrary separate charges for each vertical feature are unjust and discriminatory.

(typically based on retail data) to develop UNE expenses. In more recent proceedings, Pacific has been unable or unwilling to produce a functional copy of its expense modeling and has been unable to demonstrate if or how hundreds of millions of dollars in non-recurring expenses were supposedly removed from its recurring expense study.

VERIFICATION PAGE

I declare under penalty of perjury that the foregoing Declaration is true and correct.

/s/ Terry E. Murray

Terry E. Murray

Executed on: October 9, 2002